MENDING HEARTS, INC.

FINANCIAL STATEMENTS

JUNE 30, 2008

(With Independent Auditors' Report Thereon)

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FARMER & ASSOCIATES, PLLC

Independent Auditors' Report

To the Board of Directors
Mending Hearts, Inc.

We have audited the accompanying comparative statement of financial position of Mending Hearts, Inc. as of June 30, 2008 and the related statements of activities, changes in net assets, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above presents fairly, in all material respects, the financial position of Mending Hearts, Inc. as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Farmer & Associates, PLLC

January 07, 2009
Franklin, Tennessee

MENDING HEARTS, INC.

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2008

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 1,130
Total Current Assets	1,130
PROPERTY AND EQUIPMENT	
Furniture and equipment	11,436
Vehicles	6,000
	17,436
Less accumulated depreciation	6,669
Total Property and Equipment	10,767
OTHER ASSETS	16,500
Total Assets	$ 28,397
LIABILITIES AND NET DEFICIT	
CURRENT LIABILITIES	
Notes payable officers	19,971
Notes payable bank	24,763
Accrued expense	2,066
Accounts payable	833
Total Current Liabilities	47,634
NET DEFICIT	
Unrestricted	19,236
Temporarily restricted	-
Total Net Assets	19,236
Total Liabilities and Net Assets	$ 28,397

See notes to financial statements.

MENDING HEARTS, INC.

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED JUNE 30, 2008

Changes in unrestricted net assets:	
Support and revenue	
Grants	$ 91,855
Contributions	22,998
Fundraising	12,249
Resident fees	143,205
Interest	5
Total support and revenue	270,312
Expenses:	
Program services	165,990
Management and general	110,394
Fundraising	1,370
Total expenses	277,754
Decrease in unrestricted net assets	(7,442)
Changes in temporarily restricted net assets	
Contributions	-
Net assets released from temporary restrictions	-
Increase in temporarily restricted net assets	-
Total decrease in net assets	(7,442)
Net assets, beginning of year	(11,794)
Net assets, end of year	$ (19,236)

See notes to financial statements.

MENDING HEARTS, INC.

STATEMENT OF FUNCTIONAL EXPENSE

FOR THE YEAR ENDED JUNE 30, 2008

		Program Services	Management and General	Fundraising	Total
Payroll	$	50,040	50,038		100,078
Payroll tax		5,042	5,042		10,084
Accounting fees		3,045	3,045		6,090
Supplies		2,807	312		3,119
Conferences		180	20		200
Building rental		36,043	12,014		48,057
Repairs and maintenance		4,695	756		5,451
Utilities		19,659	6,553		26,212
Telephone, fax and internet		9,404	1,045		10,449
Bank charges		95	855		950
Office supplies and expense		2,547	2,547		5,094
Tax, license and permits		995	111		1,106
Insurance		7,040	7,040		14,080
Depreciation		1,615	179		1,794
Interest		1,184	1,184		2,368
Advertising		229	-		229
Dues and subscriptions		325	325		650
Professional fees		8,585	954		9,539
Labor		1,215	1,215		2,430
Vehicle operation		6,668	674		7,342
Drug screening		760	84		844
Food		97	870		967
Gifts and awards		364	41		405
Residents transportation		2,779	-		2,779
Resident medical		95	-		95
Miscellaneous		-	15,007		15,007
Meals and entertainment		482	483		965
Fundraising		-	-	1,370	1,370
	$	165,980	110,394	1,370	277,754

See notes to financial statements.

MENDING HEARTS, INC.

STATEMENT OF CASH FLOW

FOR THE YEAR ENDED JUNE 30, 2008

Cash Flows From Operating Activities		
Increase (decrease) in net assets	$	7,442
Adjustments to reconcile increase (decrease) in net assets to cash provided (used) by operating activities:		
In-Kind (non-cash) contributions of fixed assets		-
Depreciation		1,794
(Increase) decrease in contract receivable		-
(Increase) decrease in unconditional promises to give		-
(Increase) decrease in other assets		(6,000)
Increase (decrease) in accounts payable		(100)
Increase (decrease) in other accrued liabilities		(3,501)
Total adjustments		(7,807)
Net Cash Provided (Used) by Operating Activities		(15,249)
Cash Flows From Investing Activities		
Acquisition of plant, property, and equipment		(1,200)
Net Cash Used by Investing Activities		(1,200)
Cash Flows From Financing Activities		
Net borrowing (payments) notes payable bank		19,763
Net borrowing (payments) notes payable officers		(4,159)
Net Cash Provided (Used) by Financing Activities		15,604
Increase (decrease) in cash		(846)
Cash, beginning of year		4,053
Cash, end of year	$	3,208
Supplemental disclosures:		
Cash paid for interest	$	2,368

See notes to financial statements.

MENDING HEARTS, INC.

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF BUSINESS

Mending Hearts, Inc., a Tennessee not-for-profit corporation (the "Organization"), was organized to assist women in Tennessee seeking to overcome drug addiction by providing transitional shelter, food, clothing, counseling and other necessities. The Organization's primary sources of revenue are grants from various other charitable organizations, charitable contributions and fees charged to residents.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements of Mending Hearts, Inc. have been prepared on the accrual basis of accounting. The financial statements reflect unrestricted, temporarily restricted, and permanently restricted net assets and activities. Net assets of the two restricted classes are created only by donor-imposed restrictions on their use. All other net assets, including board-designated amounts are reported as part of the unrestricted class. The Organization had no permanently restricted net assets at June 30, 2007.

Concentration of Credit Risk

Typically, approximately forty to fifty percent of the Organization's revenue, (100% of its service fee revenue), is attributable to one source.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Promises to Give

Unconditional promises to give are recognized as revenues in the period in which the promises are made. Conditional promises to give are recognized when the conditions on which they depend are substantially met. The Organization recognized no unconditional promises to give in 2008. Promises to give are recorded at their net realizable value and are expected to be collected in less than one year.

Property and Equipment

Property and equipment are reported at cost. Donations of property and equipment are recorded as support at their estimated fair value at the date of donation. Property and equipment are depreciated principally using the straight-line method over their estimated useful lives ranging from five years for furniture and equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Long-lived Assets

The Organization periodically reviews the values assigned to long-lived assets to determine if any impairments are other than temporary. Management believes that the long-lived assets in the accompanying statements of financial position are appropriately valued.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and nature of any donor stipulations that limit the use of the donated assets either on a temporary or permanent basis. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. If a restriction is fulfilled in the same period in which the contribution is received, the Organization reports the support as unrestricted. Contributions are considered to be available for unrestricted use unless specifically restricted by the donor.

Functional Expense Allocation

The costs of providing various program and supporting services have been summarized on a functional basis in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Income Taxes

The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included in the accompanying financial statements.

Cash and Cash Equivalents:

The Organization considers all highly liquid investments and certificates of deposits with original maturities of three months or less, to be cash equivalents.

MENDING HEARTS, INC.

NOTES TO FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contributed Services

During the year ended June 30, 2008, the value of contributed services meeting the requirements for recognition in the financial statements was not material and has not been recorded. In addition, many individuals volunteer their time and perform a variety of tasks that assist the Organization at the program facilities, but these services do not meet the criteria for recognition as contributed services.

3. LINE OF CREDIT

The Organization has a line of credit arrangement with a bank with a facility of $25,000. Borrowings under the line bear interest at a rate of the prime rate as established by the lender plus one percent, which was 6% at June 30, 2008, and are secured by all assets of the Organization.

The balance at June 30, 2008 was $24,763 due and payable on demand.

4. NOTES PAYABLE TO OFFICERS

The Organization has unsecured notes payable to officers of the Organization which are due upon demand. The officers have agreed to allow the Organization to repay the debt as it is able to do so. There is no stated rate of interest; therefore imputed interest of six percent has been used at June 30, 2008.

5. OPERATING LEASE COMMITMENT

As of December 1, 2006, the Organization entered into a one-year non-cancelable operating lease for its facility at 4302 Albion Street requiring rent of $10,200 annually. As of January 1, 2008 the lease was renewed for an additional year requiring rent of $10,800. As of April 2007 the Organization renewed the one-year non-cancelable lease for its facility at 1000 Avenue North requiring rent of $18,000 annually. As of January 2008 the Organization renewed the one-year non-cancelable operating lease for its facility at 4305 Albion Street requiring rent of $24,000 per year. Concurrently with the lease of the property at 4305 Albion, an option to purchase this property for $170,000 was entered into by the Organization. The option will expire January 14, 2012 and increases the purchase price by three percent each year with the first increase April 1, 2007. This option required an $8,000 non-refundable option fee and a further $500 per month option fee paid concurrently with the rent. The option fees have been capitalized in other assets.